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May 5, 2008

EX PARTE

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

Re: *In the Matters of Federal-State Joint Board on Universal Service, High-Cost Universal Service Support*, CC Docket No. 96-45, WC Docket No. 05-337

Dear Ms. Dortch:

Qwest Communications International Inc. ("Qwest") hereby files a proposal for revising the methodology used to determine high-cost universal service support for "non-rural" incumbent local exchange carriers ("ILECs"), to comply with the Tenth Circuit Court of Appeals' decision in *Qwest II*. As discussed in the attached submission, this proposal will fulfill the fundamental principles of Section 254 and further the critical objective of facilitating broadband deployment in rural areas.

Qwest wholeheartedly supports the Federal Communications Commission's ("Commission") ongoing consideration of long-term, comprehensive universal service reform. As the Federal-State Joint Board on Universal Service ("Joint Board") has recognized, however, the Commission also must act on a more pressing universal service issue -- the Tenth Circuit's 2005 remand in *Qwest II*. Until the Commission fixes its universal service rules, it will continue to spend billions of dollars in high-cost support, while failing to accomplish the basic objective of ensuring that all rural consumers have access to telecommunications services -- including broadband -- that are reasonably comparable, in terms of quality and price, to those offered in urban areas. Thus, it is imperative that the Commission immediately adopt rules that address the Tenth Circuit's mandate.

Today, many of the nation's most sparsely populated communities served by non-rural ILECs receive little, if any, federal high-cost assistance, while the Commission sends about $350 million in "non-rural" support to a handful of states -- often to subsidize multiple wireless carriers -- and $1.5 billion in high-cost loop and local switching support provided to areas served by rural ILECs. Despite the rural nature of much of the 14 western states it serves, Qwest received only about $27 million in federal high-cost assistance in 2007, with no assistance in such rural states as Iowa and North Dakota. In contrast, wireless carriers collected more than four times that amount in non-rural high-cost support just in Mississippi -- serving areas where consumers already have a wireline alternative.

Meanwhile, vigorous competition throughout the country, and particularly in urban areas, such as Omaha, has substantially eliminated the implicit subsidies that underlie the Commission's current high-cost support rules for non-rural ILECs. Since 2003, when the Commission adopted those rules, ILECs have lost more than 30 million access lines. While the loss of implicit subsidies makes it difficult for non-rural ILECs to provide basic telephone services at reasonably comparable rates, it has an even more dramatic impact on the deployment of new services, such as broadband. In the absence of federal assistance, it is not economically feasible for Qwest and other non-rural ILECs to undertake the costly network upgrades that are necessary to offer broadband in many rural areas. A first step toward solving the problems of competition-driven loss of implicit subsidies and lack of broadband in rural areas is to target federal high-cost support to rural areas served by non-rural ILECs.

Consistent with these principles, Qwest proposes that the Commission replace the current non-rural support mechanism with federal support targeted to the highest cost wire centers (*i.e.*, those with a cost per line of more than 125 percent of the national average urban rate) served by the non-rural ILECs. These changes would increase the amount of support provided to non-rural eligible telecommunications carriers ("ETCs") by about $1.2 billion. To the extent the Commission has concerns about the size of this increase, it could reasonably decide, on an interim basis, to target wire-based federal support to the rural areas served by smaller non-rural ILECs, namely, those other than AT&T and Verizon. Given their smaller size, scale, and scope, these "medium-size ILECs" have been most affected by the loss of implicit subsidies resulting from robust competition in urban areas. By initially limiting the rule modifications to the medium-size ILECs, the Commission could limit the size of the increase in the non-rural program to about $322 million.[1] The Commission possesses adequate legal authority for such an interim approach, given the vast quantitative and qualitative differences between the medium-size ILECs and AT&T and Verizon. Moreover, courts have repeatedly deferred to Commission decisions to address complex regulatory issues on a step-by-step, rather than comprehensive, basis, and generally allow the Commission more discretion in adopting interim rules.

Regardless of whether it modifies the non-rural support mechanism for all non-rural ILECs, or only the medium-size ILECs, it is critical that the Commission move forward to address the Tenth Circuit's decision in *Qwest II*.

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[1] This figure assumes that the Commission freezes the amount of support given to competitive ETCs in these areas. Application of the identical support rule to the new high-cost support would raise the size of the increase.

Respectfully submitted,

/s/ R. Steven Davis
/s/ Shirley Bloomfield

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May 5, 2008

PROPOSAL FOR IMPLEMENTING THE TENTH CIRCUIT'S REMAND IN *QWEST II*

I. INTRODUCTION AND SUMMARY.

Qwest Communications International Inc. ("Qwest") wholeheartedly supports the Federal Communications Commission's ("Commission") ongoing consideration of long-term, comprehensive universal service reform. As the Federal-State Joint Board on Universal Service ("Joint Board") has recognized, however, the Commission also must act on a more pressing universal service issue -- the Tenth Circuit's remand in the *Qwest II* decision.[1] Three years ago, the Tenth Circuit held that the Commission's high-cost support rules for "non-rural" incumbent local exchange carriers ("ILECs") rely on an "erroneous, or incomplete, construction" of Section 254.[2] Until the Commission fixes those rules, it will continue to spend billions of dollars in high-cost support, while failing to accomplish the basic objective of ensuring that all rural consumers have access to telecommunications services -- including broadband -- that are reasonably comparable, in terms of quality and price, to those offered in urban areas. Thus, it is imperative that the Commission immediately adopt rules that address the Tenth Circuit's mandate. In this submission, Qwest outlines a proposal to modify the high-cost support program for non-rural

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[1] *In the Matter of High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, Recommended Decision, 22 FCC Rcd 20477, 20485-86 ¶ 33 (2007) ("*Recommended Decision*").

[2] *Qwest v. FCC*, 398 F.3d 1222, 1226 (10th Cir. 2005) ("*Qwest II*").

ILECs in a manner that will accomplish the objectives of Section 254 and the Commission's objectives for facilitating broadband deployment in rural areas.

Today, many of the nation's most sparsely populated communities served by non-rural ILECs receive little, if any, federal high-cost support, while the Commission sends $352 million in federal "non-rural" support to a handful of states, often to subsidize multiple wireless carriers. This is on top of the $1.5 billion in federal high-cost loop and local switching support provided in areas served by rural ILECs.[3] Despite the rural nature of much of the 14 western states it serves, Qwest received only $27 million in federal high-cost assistance in 2007, with no assistance in such rural states as Iowa and North Dakota.[4] In fact, Qwest's total support equaled the amount of support provided to non-rural eligible telecommunications carriers ("ETCs") in West Virginia and was just one-seventh of the non-rural high-cost support awarded in Mississippi.[5] Much of the "high-cost model support" in Mississippi went to wireless carriers, such as AT&T, AllTel, and Cellular South, serving areas with a wireline alternative.[6] Indeed, competitive ETCs ("CETCs") received more total high-cost support in Mississippi than did ILECs.[7]

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[3] *2007 Universal Service Monitoring Report*, CC Docket No. 98-202, Table 3.1, "High-Cost Support Fund Payment History" ("*2007 Monitoring Report*").

[4] Universal Service Administrative Company, FCC Filings – 2007, Quarterly Administrative Filings for 2007, http://www.usac.org/about/governance/fcc-filings/2007/.

[5] *2007 Monitoring Report*, Table 3.25, "High-Cost Model Support Payments By Study Area (showing total high-cost model support payments in Mississippi of about $199 million in 2007).

[6] *Id.* (reflecting high-cost model support payments of $57 million, $9 million, and $37 million to AT&T, AllTel, and Cellular South, respectively, in Mississippi in 2007).

[7] *Id.*, Table 3.15, "Total High-Cost Support Payments By State or Jurisdiction – ILECs and CETCs." In 2007, CETCs received $145 million, while ILECs were awarded $136 million.

Meanwhile, vigorous competition throughout the country, and particularly in urban areas, has substantially eliminated the implicit subsidies that underlie the Commission's current high-cost support rules for non-rural ILECs. Since 2003, when the Commission adopted those rules, ILECs, on average, have lost 18 percent of their access lines.[8] This follows the loss of more than 10 million access lines between 2000 and 2003.[9] In Omaha, Cox, rather than Qwest, now provides the majority of telephone connections, while Qwest faces similar market conditions in other urban areas, such as Denver, Minneapolis, Phoenix, and Seattle.

These trends hamper the ability of non-rural ILECs, such as Qwest, to provide services in rural areas that are reasonably comparable to those services provided in urban areas.[10] While the loss of implicit subsidies makes it difficult for non-rural ILECs to provide basic telephone services at reasonably comparable rates, it has an even more dramatic impact on the deployment of new services, such as broadband. Qwest currently offers broadband services to approximately 85 percent of the households in its region. In order to expand its broadband footprint, Qwest must undertake costly upgrades to its network. In the absence of additional federal assistance, however, such upgrades are not economically feasible in many rural areas. A first step toward solving the problems of competition-driven loss of implicit subsidies and lack of broadband in rural areas is to target federal high cost support to rural areas served by non-rural ILECs. As Chairman Martin has noted, universal service must "ensure access to telecommunications

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[8] *Local Telephone Competition: Status as of June 30, 2007*, Industry Analysis and Technology Division, Wireline Competition Bureau, March 2008, Table 4 ("*2007 Local Telephone Competition Report*").

[9] *Id.*

[10] 47 U.S.C. § 254(b)(3).

services that are comparable to those available in urban areas today, as well as provide a platform for delivery of advanced services."[11]

Consistent with these principles, Qwest proposes that the Commission replace the current non-rural support mechanism with federal support targeted to the highest cost wire centers served by the non-rural ILECs. In order to "advance" universal service, as required by Section 254 and *Qwest II*, the Commission would reduce the current benchmark to 125 percent of the national average urban rate, and provide federal support above that threshold. These changes would increase the amount of support provided to non-rural ETCs by $1.2 billion.[12] The approximate distribution of support across the states is shown in Attachment B. In accord with the Joint Board's recommendation, this additional support would not be subject to any cap on support adopted by the Commission.[13]

To the extent the Commission has concerns about increasing the size of the non-rural support mechanism, it could reasonably decide, on an interim basis, to target wire-based federal support to the rural areas served by smaller non-rural ILECs. Given their smaller size, scale, and scope, these "medium-size ILECs"[14] have been most affected by the loss of implicit subsidies resulting from robust competition in urban areas. By initially limiting the rule modifications to the medium-size ILECs, the Commission could limit the size of the increase in the non-rural

[11] *Notice of Proposed Rulemaking*, FCC 08-22, Statement of Chairman Kevin J. Martin.

[12] This figure assumes that the Commission freezes the amount of support given to CETCs in these areas. Application of the identical support rule to the new high-cost support would increase this number.

[13] *Recommended Decision*, 22 FCC Rcd at 20487 ¶ 26 n.26. ¶ 42.

[14] For purposes of this proposal, "medium-size ILECs" refer to non-rural carriers with fewer than 25 million access lines nationwide. Currently, all non-rural carriers except AT&T and Verizon fall under this threshold.

program to about $322 million. While Qwest would receive approximately $200 million of this support, this is just a fraction of the $1.1 billion in support provided to CETCs in 2007.[15]

The Commission possesses adequate legal authority for such an interim approach. Nothing in the statute precludes the Commission from limiting the proposed changes to medium-size ILECs, particularly where those carriers are most severely affected by the accelerating loss of implicit subsidies. By any measure, each of the medium-size ILECs is only a fraction the size of AT&T and Verizon, and lacks the economies of scale of the larger companies.[16] The medium-size ILECs also lack the access to capital enjoyed by AT&T and Verizon. Indeed, both of the larger companies have invested billions of dollars in aggressive roll-outs of new fiber networks designed to compete with cable companies and retain customers, and recently committed billions more on new wireless spectrum. These investments, coupled with their ownership of the nation's largest wireless providers, provide AT&T and Verizon a scope unlike that enjoyed by any of the medium-size ILECs.

Moreover, courts have repeatedly deferred to Commission decisions to address complex regulatory issues on a step-by-step, rather than comprehensive, basis. Likewise, courts generally allow the Commission more discretion in adopting interim rules. Finally, the Commission has previously recognized that smaller carriers are more vulnerable to significant changes in universal service support, justifying differing regulatory regimes.

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[15] *2007 Monitoring Report*, Table 3.15, "Total High-Cost Support Payments By State or Jurisdiction – ILECs and CETCs."

[16] In terms of market capitalization, for example, even the largest medium-size ILEC (Qwest) is only 8 percent the size of Verizon and less than 4 percent the size of AT&T. *See* Qwest Comm. Intl. Inc., Apr. 28, 2008 (market capitalization of $8.69 billion), http://finance.yahoo.com/q?s=q, Verizon Commun., Apr. 28, 2008 (market

Regardless of whether it modifies the non-rural support mechanism for all non-rural ILECs, or only the medium-size ILECs, it is critical that the Commission move forward to address the Tenth Circuit's decision in *Qwest II.*

II. THE TIME HAS COME FOR THE COMMISSION TO COMPLY WITH THE TENTH CIRCUIT'S REMAND IN *QWEST II.*

A dozen years after the passage of the Telecommunications Act of 1996, the Commission has yet to adopt lawful rules implementing Section 254's "reasonable comparability" mandate. During that time, the Commission has twice attempted to adopt compliant rules, but both times the U.S. Court of Appeals for the Tenth Circuit found that those rules failed to ensure that rates in rural areas served by non-rural ILECs are reasonably comparable to rates in urban areas. In the meantime, pervasive competition has continued to chip away at the implicit subsidies that, in the past, have enabled rates in most rural areas to remain reasonably comparable to urban rates. The loss of implicit subsidies also has undermined non-rural ILECs' ability in rural areas to provide broadband and other services that are reasonably comparable to those services provided in urban areas. Given their smaller, size, scale, and scope, these concerns are magnified for the medium-size ILECs. For these reasons, the Commission must revise its non-rural high-cost support mechanism to provide "sufficient" support to accomplish the objectives set forth in Section 254, as well as the goal of furthering broadband deployment in rural areas.

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capitalization of $108.95 billion), http://finance.yahoo.com/q?s=vz; AT&T Inc., Apr. 28, 2008 (market capitalization of $227.46 billion) http://finance.yahoo.com/q?s=t.

A. The Commission's Current High-Cost Rules Do Not Ensure That Consumers In Rural Areas Served By Non-Rural ILECs Have Access To "Reasonably Comparable" Services At "Reasonably Comparable" Rates.

For most of the last century, the principal strategy for ensuring "universal service" was reliance on the "implicit" subsidies that were built into the Bell System's telephone rate structures.[17] These implicit subsidies took the form of geographically averaged rates, above-cost long-distance rates, and above-cost business rates.[18] Thus, a single company -- initially the Bell System and later each of the ILECs -- was "expected to obtain revenues from services at levels above 'cost' (*i.e.*, above competitive price levels) and to price other services allegedly below cost."[19]

At least in theory, this all changed with the passage of the 1996 Act. The 1996 Act embraced both competition and universal service -- by supporting universal service goals through an explicit subsidy mechanism and the phasing out of implicit subsidies. The 1996 Act further directed the Commission to establish rules ensuring that consumers in rural, insular and high-cost areas "have access to telecommunications and information services . . . that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas."[20]

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[17] *See In the Matter of Federal-State Joint Board on Universal Service*, Report and Order, 12 FCC Rcd 8776, 8784 ¶ 10 (1997) ("*Universal Service First Report and Order*"), "Today, universal service is achieved largely through implicit subsidies."

[18] *See* Jonathan E. Nuechterlein & Philip J. Weiser, *Digital Crossroads: American Telecommunications Policy in the Internet Age* 334-35 (The MIT Press 2005).

[19] *Universal Service First Report and Order*, 12 FCC Rcd at 8784 ¶ 10 n.15.

[20] 47 U.S.C. § 254(b)(3).

The Commission first attempted to implement this mandate in the *Ninth Report and Order* adopted in 1999. There, the Commission established a non-rural support mechanism that provided federal funding to the non-rural carriers in a state to the extent the statewide average cost exceeded a benchmark of 135 percent of the national average cost per line.[21] The Commission found that this methodology implemented its goal of "enabling states to ensure the reasonable comparability of non-rural carriers' intrastate rates."[22] In 2001, the Court of Appeals for the Tenth Circuit reversed and remanded these rules, concluding, among other things, that the Commission had not adequately defined key terms such as "sufficient" and "reasonably comparable," and that the Commission had failed to explain how its funding benchmark of 135 percent would help achieve the goals of sufficiency and reasonable comparability.[23] The Tenth Circuit directed the Commission "to define these terms more precisely in a way that can be reasonably related to the statutory principles, and then to assess whether its funding mechanism will be sufficient for the principle of making rural and urban rates reasonably comparable."[24] The Court also required the Commission to revisit the 135 percent benchmark and "provide adequate record support and reasoning for whatever level of support it ultimately selects upon remand."[25] The Court also directed the Commission to develop adequate "inducements" to

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[21] *In the Matter of Federal-State Joint Board on Universal Service*, Ninth Report and Order and Eighteenth Order on Reconsideration, 14 FCC Rcd 20432, 20457-58 ¶ 45 (1999) ("*Ninth Report and Order*").

[22] *Id.* at 20436-37 ¶ 6.

[23] *Qwest v. FCC,* 258 F.3d 1191, 1198 (10th Cir. 2001) ("*Qwest I*").

[24] *Id.* at 1202.

[25] *Id.* at 1203.

ensure that states take appropriate actions to provide for reasonable comparability between rural and urban rates, as the statute requires.[26]

In 2003, the Commission adopted new rules on remand.[27] The Commission retained the basic framework adopted in the *Ninth Report and Order*, continuing to base support on a comparison of statewide average costs to a nationwide cost benchmark.[28] The Commission defined "sufficient" as enough federal support to enable states to achieve reasonable comparability,[29] and defined rural rates as "reasonably comparable" if they fall within two standard deviations, or roughly 138 percent, of the national urban average.[30] Federal support is available in a state only to the extent the statewide average cost exceeds two standard deviations of the national average cost per line.[31] Finally, in order to induce states to achieve reasonably comparable rates, the Commission adopted a rate review and expanded certification process. Under this process, states are permitted to request "further federal action," if necessary, based on a demonstration that the state's rates in rural, high-cost areas served by non-rural carriers are not reasonably comparable to urban rates nationwide and that the state has taken all reasonable steps to achieve reasonable comparability through state action and existing federal support.[32]

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[26] *Id.* at 1203-04. Finally, the court required the Commission to explain its complete plan for supporting universal service. *Id.* at 1205.

[27] *In the Matter of Federal-State Joint Board on Universal Service*, Order on Remand, Further Notice of Proposed Rulemaking, and Memorandum Opinion and Order, 18 FCC Rcd 22559 (2003) ("Order on Remand").

[28] *Id.* at 22572-78 ¶¶ 23-29.

[29] *Id.* at 22581 ¶ 36.

[30] *Id.* at 22582 ¶ 38.

[31] *Id.* at 22591-92 ¶ 53 n.196.

[32] *Id.* at 22601-616 ¶¶ 70-96. Wyoming filed such a request in 2004. Joint Petition of the Wyoming Public Service Commission and the Wyoming Office of Consumer Advocate for Supplemental Federal Universal Service Funds for

Two years later, in *Qwest II*, the Tenth Circuit for a second time invalidated the Commission's universal service high-cost rules for non-rural carriers, this time on two primary grounds: (a) the Commission's interpretation of the statutory term "sufficient" ignores the majority of the principles in Section 254(b)(3), including affordability;[33] and (b) the Commission's definition of "reasonably comparable" is "manifestly contrary to the statute," because it ignores the Commission's obligation to "advance" universal service, which "certainly could include a narrowing of the existing gap between urban and rural rates."[34] Moreover, the comparability benchmark adopted by the Commission pursuant to this definition "ensured that significant variance between rural and urban rates will continue unabated."[35]

While the Tenth Circuit did not set a deadline for Commission action, it "fully expect[ed] the FCC to comply with [its] decision in an expeditious manner, bearing in mind the consequences inherent in further delay."[36] Three years later, however, the Commission has not addressed the Court's mandate to adopt lawful rules implementing these core requirements of the 1996 Act.[37]

Customers of Wyoming's Non-Rural Incumbent Local Exchange Carrier, CC Docket No. 96-45 (filed Dec. 21, 2004). That request is still pending.

[33] *Qwest II*, 398 F.3d at 1233-34.

[34] *Id.* at 1236.

[35] *Id.*

[36] *Id.* at 1239.

[37] On December 9, 2005, the Commission issued a Notice of Proposed Rulemaking in response to the *Qwest II* remand. *See In the Matter of Federal-State Joint Board on Universal Service; High-Cost Universal Service Support*, Notice of Proposed Rulemaking, 20 FCC Rcd 19731 (2005). The resulting record closed nearly two years ago.

B. Competition Has Accelerated Dramatically Since The *Order On Remand*, Further Threatening Reasonably Comparable Rates In Rural Areas Served By Non-Rural ILECs.

Meanwhile, reasonably comparable rates are under threat in rural areas served by non-rural ILECs. As the Commission has long recognized, the cost of providing service in rural areas tends to be higher than that in urban areas, because of long loop lengths and a smaller customer base over which to spread network costs.[38] Indeed, in many rural areas served by Qwest, the cost of providing "supported services" exceeds the rate that Qwest can charge for those services.[39] For such areas, ILECs have two primary means of making up this "shortfall": (i) *implicit* subsidies generated by revenues from lower cost, urban areas,[40] and (ii) *explicit* federal or state universal subsidies.[41]

The Commission still relies heavily on the existence of implicit subsidies to maintain reasonably comparable rates in rural areas served by non-rural carriers. The current federal fund provides only a fraction of the support necessary to keep rates in rural wire centers served by

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[38] *Order on Remand*, 18 FCC Rcd at 22567 n.31.

[39] By "supported services," we mean those services that are subsidized by federal high-cost support pursuant to Section 254(c) of the Act.

[40] In some cases, there may still be implicit subsidies in the rates for certain intrastate services. At the federal level, the Commission removed implicit subsidies in interstate access rates in the *CALLS Order*. *See In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 96-262 and 94-1, Sixth Report and Order, *Low-Volume Long Distance Users*, CC Docket No. 99-249, Report and Order, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Eleventh Report and Order, 15 FCC Rcd 12962 (2000) ("*CALLS Order*"), *aff'd in part, rev'd in part, and remanded in part, Texas Office of Public Util. Counsel et al. v. FCC*, 265 F.3d 313 (5th Cir. 2001), *cert. denied, National Association of State Utility Consumer Advocates v. FCC*, 535 U.S. 986 (2002); *on remand, Access Charge Reform; Price Cap Performance Review for LECs; Low-Volume Long Distance Users; Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-262, 94-1, 99-249 and 96-45, Order on Remand, 18 FCC Rcd 14976 (2003).

[41] It is also possible to reduce such shortfalls by selling additional services to the rural customers. In many high-cost areas, however, the total revenues from all services provided to the customers in those areas fall short of the cost of providing service.

non-rural carriers within a reasonable range of the national average rate. Overall, non-rural carriers receive only about 25 percent of the federal high-cost support they would receive if the Commission fully funded a wire center-based support mechanism with the current 137 percent benchmark.[42] At the local level, Qwest and other non-rural ILECs serve thousands of rural wire centers with very high costs -- as determined by the Commission's Synthesis Model -- yet receive little, if any, explicit federal support for those wire centers. For example, Qwest serves Patagonia, AZ (Synthesis Model monthly cost $127 per line), Deckers, CO (SM monthly cost $137 per line), Rose Hill, IA (SM monthly cost $162 per line), Comstock, MN (SM monthly cost $221 per line), and Leonard, ND (SM monthly cost $204 per line), but receives no federal high-cost support in any of these areas. There are hundreds of other examples of Qwest wire centers with costs above the national average where Qwest receives no federal high-cost support.

In the *Order on Remand*, the Commission declined to take any action to address the erosion of implicit subsidies, despite its recognition that "section 254 states a clear preference for explicit, rather than implicit, support[.]"[43] The Commission found that the Act does not require states to adopt explicit universal service support mechanisms,[44] and it also does not require the Commission to replace implicit state support with explicit federal support.[45] The Commission

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[42] In 2008, non-rural ILECs are projected to receive $352 million in federal high-cost support, (*see Federal Universal Service Support Mechanisms Fund Size Projections for the First Quarter 2008*, dated Nov. 2, 2007 at 9 ("Based on these projections, total annual 2008 HCM support is estimated to be $351.47 million."), while they would receive more than $1.4 billion if the Commission provided support at the wire center level using the current 137 percent benchmark.

[43] *See Order on Remand,* 18 FCC Rcd at 22574-75 ¶ 26.

[44] *Id.* The Commission also found that "requiring the states to establish explicit universal service support mechanisms raises serious legal concerns in light of section 2(b) of the Communications Act." *Id.*

[45] *Id.* at 22577-78 ¶ 29.

also concluded that immediate action in this regard was not necessary at that time. According to the Commission, data from the General Accounting Office confirmed that "urban and rural rates nationwide [in 2002] generally remained reasonably comparable," and the impact of competition ha[d] not been geographically ubiquitous or long-lived enough to assess definitively its effect on rates for universal service purposes."[46]

Now, five years later, vigorous competition in the telecommunications industry is both geographically ubiquitous and long-lived. In many relatively urban areas, ILECs have lost a substantial portion of their access lines.[47] Nationwide, ILECs lost about 18 percent of their switched access lines between June 2003 and June 2007.[48] These line losses have resulted, in part, from tremendous growth in intermodal competition over the past five years.[49]

In the Omaha Metropolitan Statistical Area ("MSA"), Cox now has the largest share of the market for telephony. In 2005, the intense competition faced by Qwest in Omaha led the Commission to forbear from certain types of dominant carrier and unbundling regulation in that MSA.[50] Qwest faces comparable market conditions in Denver, Minneapolis-St. Paul, Phoenix,

[46] *Id.* at 22605-06 ¶ 77. On appeal, the Tenth Circuit found that the record in the remand proceeding did not support the Commission's conclusion in this regard. *Qwest II*, 398 F.3d at 1226.

[47] Petitions of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Denver, Minneapolis-St. Paul, Phoenix, and Seattle MSAs, WC Docket No. 07-97, filed Apr. 27, 2007 (Denver Petition at 17-18; Minneapolis-St. Paul Petition at 18-20; Phoenix Petition at 17-19; Seattle Petition at 17-20).

[48] *2007 Local Telephone Competition Report*, Table 4.

[49] They also are attributable to the substitution of other services, such as broadband-enabled Internet and e-mail services, for traditional telephone services. While ILECs provide broadband services, cable providers continue to serve the majority of broadband consumers. *High-Speed Services for Internet Access: Status as of June 30, 2007*, Industry Analysis and Technology Division, Wireline Competition Bureau, Chart 6 (March 2008).

[50] *In the Matter of Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Omaha Metropolitan Statistical Area*, Memorandum Opinion and Order, 20 FCC Rcd 19415 (2005) ("*Omaha Forbearance Order*"), *pets. for rev. dismissed and denied on the merits, Qwest v. FCC*, 482 F.3d 471 (D.C. Cir. 2007).

and Seattle, which Qwest has documented in its pending forbearance petitions for those MSAs.[51] Such competition is by no means limited to Qwest's serving territory. The Commission has found, for example, that market conditions in the Anchorage MSA warranted regulatory forbearance similar to that granted in the *Omaha Forbearance Order*.[52]

Residential and business customers throughout the country now have access to a variety of competitive alternatives for affordable telephone services. Such alternatives include cable service providers (providing either circuit switched or facilities-based Voice over Internet Protocol ("VoIP") services), wireline competitive local exchange carriers ("CLECs"), wireless carriers, and "over-the-top" VoIP providers.[53] Cable providers, such as Cox Communications, Comcast, and Time Warner, have achieved great success over the past several years, with a total of more than 15 million voice customers.[54] Likewise, cell phone usage has exploded since the issuance of the *Order on Remand*. Between 2003 and 2006, CMRS providers added about 80 million new customers, increasing the overall wireless penetration rate from 54 percent to 80

[51] Denver Petition, *generally*, Minneapolis-St. Paul Petition, *generally*, Phoenix Petition, *generally*, Seattle Petition, *generally*.

[52] *In re Petition of ACS of Anchorage, Inc. Pursuant to Section 10 of the Communications Act of 1934, as Amended, for Forbearance from Sections 251(c)(3) and 252(d)(1) in the Anchorage Study Area*, Memorandum Opinion and Order, 22 FCC Rcd 1958, 1959-60 (2007) (granting certain unbundling relief), *appeals dismissed*, *Covad Communications Group, Inc. v. FCC*, Nos. 07-70898, 07-71076, 07-71222 (9th Cir. 2007); *In re Petition of ACS of Anchorage, Inc. Pursuant to Section 10 of the Communications Act of 1934, as amended (47 U.S.C. Section 160(c)), for Forbearance from Certain Dominant Carrier Regulation of Its Interstate Access Services, and for Forbearance from Title II Regulation of Its Broadband Services in the Anchorage, Alaska, Incumbent Local Exchange Carrier Study Area*, Memorandum Opinion and Order, 22 FCC Rcd 16304 (2007) (granting certain dominant carrier relief).

[53] *See, e.g.*, Phoenix Petition at 5. "Over-the-top" VoIP service can be used over any broadband connection, which is available from a number of sources, including providers of cable modem service, DSL, wireless broadband, and satellite.

[54] National Cable Television Association, Statistics, http://www.ncta.com/Statistic/Statistic/Statistics.aspx. This growth continues, as Cox, for example, recently reported an annual increase in telephone customers of 17.7 percent in 2007. *Cox Celebrates 7th Consecutive Year Adding More than One Million New Revenue Generating Units*, http://phx.corporate-ir.net/phoenix.zhtml?c=76341&p=irol-newsArticle&t=Regular&id=1107954&.

percent.[55] In fact, wireless subscribers now exceed ILEC access lines by more than one third.[56] A growing percentage of Americans have "cut the cord," relying exclusively on wireless service for their voice telecommunications needs. According to one survey, one out of every eight adults in 2006 lived in households with only wireless phones, which is triple the percentage in 2003.[57] In many instances, even if they do not "cut the cord" subscribers have removed a second landline in favor of wireless service and/or shifted a significant amount of telephone usage to wireless service. In each of these instances, demand for the ILEC's wireline telephone service is reduced, even though the customers have not disconnected their wireline telephone service entirely.

Over-the-top VoIP providers provide another competitive alternative to ILECs. While such service is generally already available wherever there is a broadband connection, industry analysts predict exponential VoIP growth in the future. For instance, the Yankee Group, a major research firm that regularly studies the communications industry in the U.S., found that "VoIP adoption continued at an aggressive pace in 2006, growing more than 125% and reaching more than 9 million subscribers" and that "consumer VoIP will reach more than 37 million subscribers

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[55] *In the Matter of Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993; Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Services*, Twelfth Report, 23 FCC Rcd 2241, 2326-29 ¶ 206 (2008) ("*Twelfth Wireless Competition Report*").

[56] As of June 2007, ILECs retained 146 million switched access lines, while wireless providers boasted 238 million mobile wireless customers. *2007 Local Telephone Competition Report*, Tables 4 and 14.

[57] *Twelfth Wireless Competition Report*, 23 FCC Rcd at 2340-41 ¶ 246. In addition, the most recent National Health Interview Survey, the Commission's primary source of wireless substitution data, states: "in the first 6 months of 2007, 13.6% of households did not have a traditional landline telephone, but did have at least one wireless telephone." NHI Survey, January-June 2007, page 2 (rel. Dec. 10, 2007). As recently as 2005, the NHIS data indicated that 7.8 percent of households with wireless telephone service had "cut the cord," showing that the rate of such substitution has nearly doubled over that period of time, with no indication that the upward trend is abating.

in 2011."[58] Since VoIP calls do not rely on the ILEC's switched network (and calls transported via non-ILEC broadband facilities do not rely on the ILEC's local loop network), the rapid customer adoption of VoIP represents an additional form of competition that bypasses the ILEC.

Regardless of the cause, these competitive losses have reduced the amount of implicit subsidies available to subsidize rates in higher cost rural areas.[59] As these implicit subsidies erode, it is increasingly untenable for non-rural ILECs in rural areas to provide services that are reasonably comparable in function and price to those provided in urban areas, without corresponding *explicit* subsidies that recognize the actual cost of providing service in those areas. As the Fifth Circuit has observed, "[i]n a competitive environment, a carrier that tries to subsidize below-cost rates to rural customers with above-cost rates to urban customers is vulnerable to a competitor that offers at-cost rates to urban customers."[60]

C. Loss Of Implicit Subsidies Also Undermines Non-Rural ILECs' Ability To Provide Reasonably Comparable *Services*, Including Broadband, In Rural Areas.

No carrier can maintain the status quo in its rural areas in the face of a significant loss of the implicit subsidies that historically have subsidized rural rates. Ultimately such carriers face a stark choice, short of selling their rural exchanges: raise rates in their rural areas or reduce their

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[58] http://www.yankeegroup.com/pressReleaseDetail.do?actionType=getDetailPressRelease&ID=1020.

[59] Similar line losses in rural areas have tended to increase the per-line cost of providing service in those areas, because the ILEC still must maintain its outside plant throughout its service territory. In one dramatic example, Qwest's competitor now serves 93 percent of the access lines in Qwest's exchange in Terry, MT. *In the Matter of Qwest Petition for Forbearance Under 47 U.S.C. § 160(c) from Resale, Unbundling and other Incumbent Local Exchange Requirements Contained in Sections 251 and 271 of the Telecommunications Act of 1996 in the Terry, Montana Exchange*, Memorandum Opinion and Order, WC Docket No. 02-78, FCC 08-118 (2008). Despite these competitive losses, Qwest still shoulders the cost of maintaining the network plant to provide service in such areas, with little associated revenue.

[60] *TOPUC v. FCC*, 183 F.3d 393, 406 (5th Cir. 1999) (subsequent case history omitted).

network investment in those areas. Both of these options threaten the "reasonable comparability" mandate. An increase in rates in rural areas could mean that consumers in those areas will not have access to services "at rates that are reasonably comparable to rates charged for similar services in urban areas," as required by Section 254(b)(3) of the Act. On the other hand, reducing or withholding network investment in rural areas jeopardizes access to telecommunications and information services, including broadband, "that are reasonably comparable to those services provided in urban areas."[61]

In practice, the first option of raising rates in rural areas often is not available, because of state prohibitions and the significant administrative expense of maintaining geographically disaggregated rates. Thus, a non-rural ILEC's most likely response to the loss of implicit subsidies is to try to lower its operating costs in rural areas. Indeed, without an adequate potential return on investment, a non-rural ILEC has little incentive to invest in such areas. Yet reducing network investment in rural areas can negatively affect the quality of existing services, and also delay the deployment of new services, such as broadband.

From a legal and policy perspective, this situation creates two significant concerns. First, as noted, the loss of implicit subsidies creates a significant risk that consumers will not have access to telecommunications and information services that are reasonably comparable to those services available in urban areas, as they are entitled under the Act. Second, the absence of sufficient universal service support in rural areas served by non-rural carriers threatens the

[61] 47 U.S.C. § 254(b)(3).

Commission's efforts to facilitate the deployment of advanced services throughout the country.[62] It is widely agreed that broadband has become an essential service, necessary for citizens to participate fully in the 21st Century economy,[63] and broadband deployment in rural areas continues to be one of the Commission's top priorities.[64]

Thus, there are compelling reasons for the Commission to address the impact of these changing market conditions. Indeed, regardless of its earlier findings regarding the extent of its statutory duty to replace implicit state support with explicit federal support,[65] the Commission certainly has a duty to address the loss of implicit state support to the extent it threatens other

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[62] *See* 47 U.S.C. § 254(b)(2) ("Access to advanced telecommunications and information services should be provided in all regions of the Nation.").

[63] *See, e.g.*, Robert D. Atkinson, *The Case for a National Broadband Policy*, The Information Technology and Innovation Foundation (June 2007); Robert W. Crandall & Charles L. Jackson, *The $500 Billion Opportunity: The Potential Economic Benefit of Widespread Diffusion of Broadband Internet Access*, Criterion Economics (2001) (estimating that universal broadband adoption could yield annual consumer benefits of $300 billion); Jed Kolko, *Why Should Governments Support Broadband Adoption?* Working Paper No. 2007.01 at 29, Public Policy Institute of California (Jan. 2007) (suggesting that the recognized benefits of broadband may extend beyond health, education and employment to include online purchasing, which will result in lower prices for consumers who are disadvantaged by the "traditional" retail process.).

[64] *Notice of Proposed Rulemaking*, FCC 08-22, Statement of Chairman Kevin J. Martin ("Our universal service program must continue to promote investment in rural America's infrastructure and ensure access to telecommunications services that are comparable to those available in urban areas today, as well as provide a platform for delivery of advanced services"); *Recommended Decision*, Statement of Commission Michael J. Copps, Approving in Part, Concurring in Part ("Bringing broadband to the far corners of the nation is the central infrastructure challenge our country confronts right now."); *Notice of Proposed Rulemaking*, FCC 08-22, Statement of Commission Jonathan S. Adelstein, Approving in FCC 08-22, Approving in FCC 08-4, Concurring in Part, Dissenting in Part in FCC 08-5 ("I have long argued that the universal service fund is an integral component of our efforts to meet the broadband challenge."); *id.*, Statement of Commissioner Deborah Taylor Tate ("Going forward, the Universal Service Fund will continue to play a critical and increasing role in one of our top priorities at the Commission – encouraging broadband deployment to all corners of America.").

[65] *See Order on Remand,* 18 FCC Rcd at 22574-75 ¶ 26.

statutory and policy imperatives. And, as the Tenth Circuit has found, the Commission "may not simply assume that the states will act on their own to preserve and advance universal service."[66]

Notably, this issue of ensuring access to reasonably comparable services, particularly advanced services, in rural areas is primarily a concern in those areas served by non-rural carriers. In areas served by "rural" ILECs, there are countless instances of small telephone companies deploying costly, state-of-the-art broadband services in sparsely-populated areas.[67] Absent federal assistance, however, such deployments would be economically infeasible and simply would not happen. Until the Commission provides sufficient federal support for rural areas served by non-rural ILECs, broadband deployments in some of these areas remain economically infeasible.

Currently, Qwest's broadband services are available to about 85 percent of the households in Qwest's region. The company is constantly seeking to expand its broadband footprint, but in some rural areas the potential financial return is insufficient to make the deployment of broadband feasible. Targeted federal high-cost support could certainly change that situation.[68] By moving now to address the Tenth Circuit's remand, the Commission can also facilitate the statutory goal of facilitating the deployment of advanced services.[69]

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[66] *Qwest I*, 258 F.3d at 1204. Furthermore, the Commission has concluded that forcing states to establish explicit universal service support mechanisms would raise "serious legal concerns." *Order on Remand,* 18 FCC Rcd at 22574-75 ¶ 26.

[67] For example, Zona Communications (formerly Accipiter Communications) in Arizona apparently provides fiber to the home in very rural areas. *Fiber to the Home*, http://www.zonacommunications.com/services/internet/ftth.asp.

[68] Clearly there are a number alternatives for facilitating the deployment of broadband services in rural areas, including the creation of a broadband fund. *See In the Matter of High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rulemaking, FCC 08-22 (Jan. 29, 2008) (seeking comment on the Joint Board's recommendation for comprehensive reform of high-cost universal service support) ("*Comprehensive Reform NPRM*") Qwest generally supports this approach and has submitted its own proposal on this topic. *See* Letter from Melissa Newman to Marlene H. Dortch,

D. The Loss Of Implicit Subsidies Particularly Impacts Medium-Size Non-Rural ILECs.

The problems resulting from the loss of implicit subsidies, and inadequate universal service support, are most acute for non-rural ILECs that lack the size, scale, and scope of AT&T and Verizon. By any measure, each of these medium-size ILECs is only a fraction the size of AT&T and Verizon,[70] and lacks the economies of scale of the larger companies. The medium-size ILECs also lack the access to capital enjoyed by AT&T and Verizon. Indeed, both of the larger companies have invested billions of dollars in aggressive roll-outs of new fiber networks designed to compete with cable companies and retain customers, and recently committed billions more on new wireless spectrum.[71] These investments, coupled with their ownership of the

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FCC, CC Docket No. 96-45 (July 9, 2007). *See also* Qwest Comments, WC Docket No. 05-337, CC Docket No. 96-45 (filed Apr. 17, 2008). As outlined herein, however, the Commission must take steps to ensure compliance with the requirement of Section 254(b)(3) that reasonably comparable services and rates be available in rural and urban areas.

[69] *See, e.g.*, 47 U.S.C. § 254(b)(2); *In the Matters of Appropriate Framework for Broadband Access to the Internet over Wireline Facilities, et al.*, CC Docket Nos. 02-33, *et al.*, Policy Statement, 20 FCC Rcd 14986, 14987 ¶ 2 (2005) ("Specifically, Congress states that it is the policy of the United States …'to promote the continued development of the Internet….' [citation omitted, and] section 706 of the Act … charges the Commission with 'encourag[ing] the deployment on a reasonable and timely basis of advanced telecommunications capability' – broadband – 'to all Americans.'" [citation omitted]).

[70] As noted, *supra* note 16, Qwest, the largest of the medium-size ILECs, is less than one-tenth the size of Verizon and one-twentieth the size of AT&T in terms of market capitalization.

[71] AT&T Raises Spending Outlook for U-Verse Expansion, Nov. 6, 2007 ("total spending on the service from January 2007 through the end of 2008 [expected] to be between $4.5 billion and $5.0 billion"), http://www.reuters.com/article/technology-media-telco-SP/idUSN0640400220071106?pageNumber=1; Verizon to Pump $18B Into FiOS By 2010, Sept. 27, 2006, http://www.lightreading.com/document.asp?doc_id=104704&f_src=lightreading_default; AT&T Acquires Key Spectrum To Set Foundation For Future Of Wireless Broadband, More Choices For Customers, Apr. 3, 2008, http://www.att.com/gen/press-room?pid=4800&cdvn=news&newsarticleid=25428; Verizon: Spectrum Win To Propel New Wireless Network By 2010, Apr. 4, 2008 ("Verizon Wireless disclosed Friday an aggressive timetable for using more than $9 billion in spectrum licenses the company won recently."), http://news.morningstar.com/newsnet/ViewNews.aspx?article=/DJ/200804041006DOWJONESDJONLINE000724_univ.xml.

nation's largest wireless providers, provide AT&T and Verizon a scope unlike that enjoyed by any of the medium-size ILECs.[72]

Given these disparities between the medium-size ILECs and AT&T and Verizon, the Commission could reasonably focus on ensuring reasonable comparability in the areas served by the medium-size ILECs, before tackling the potentially much more costly issue with respect to the largest non-rural ILECs. Since 1999, when the Commission split ILECs into two groups (*i.e.,* "rural" and "non-rural") for purposes of its universal service rules,[73] a series of mergers have made AT&T and Verizon quantitatively *and* qualitatively different from the remaining non-rural ILECs. The Commission's statutory obligation to "advance" universal service requires the agency to adopt evolving rules that recognize these changes in the market.[74]

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[72] Compare the significant revenue growth that AT&T and Verizon have experienced recently in their wireless operations in contrast to medium-size ILECs, many of which do not possess such operations, especially of comparable size and scope. *See, e.g.*, AT&T Delivers Strong Fourth Quarter, Reaffirms 2008 and Multi-Year Outlook; Results Highlighted by Record Wireless Gains, Significant Step Up in Enterprise Services Growth, San Antonio, Texas, Jan. 24, 2008 ("16.3 percent increase in total wireless revenues with wireless data revenues up a robust 57.5 percent"; "Fourth-quarter results were highlighted by record wireless gains…"). http://www.att.com/gen/press-room?pid=4800&cdvn=news&newsarticleid=25073. *And see*, Verizon Caps Successful Year with Strong 4Q Results, Monday Jan. 28, 2008 ("Significant Gains in All Strategic Areas; Verizon Wireless Leads Industry in Key Metrics"; "2.0 million total net customer additions, 1.9 million net retail customer additions; 65.7 million total customers, 63.7 million retail (non-wholesale) customers; 6.9 million retail net adds in 2007, the most of any carrier."). *Also*, "Wireless Strength Continues for Quarter, Full Year . . . Total revenues in the quarter were $11.4 billion, up 13.3 percent; service revenues were $9.9 billion, up 13.7 percent, driven by customer growth and demand for data services. Full-year revenues were $43.9 billion, up 15.3 percent." http://investor.verizon.com/news/view.aspx?NewsID=885.

[73] *See Ninth Report & Order*, 14 FCC Rcd at 20438 ¶ 9.

[74] *See Qwest II*, 398 F.3d at 1236.

III. THE COMMISSION SHOULD REVISE THE NON-RURAL SUPPORT MECHANISM TO ENSURE SUFFICIENT FEDERAL SUPPORT AND THE AVAILABILITY OF REASONABLY COMPARABLE RATES AND SERVICES IN RURAL AREAS.

In light of the loss of implicit subsidies brought on by widespread competition in urban areas, the Commission should take immediate action to target additional federal support to rural areas served by non-rural carriers. Such action cannot await comprehensive universal service reform, though comprehensive reform surely must comply with the Tenth Circuit's mandate. The most direct means of ensuring sufficient support in rural areas is for the Commission to target support to wire centers with costs that exceed a particular benchmark, which Qwest recommends the Commission set at 125 percent of the national average rate. Ideally, the Commission would move expeditiously to modify the high-cost support methodology for all non-rural ILECs. In light of pending proposals for comprehensive reform, however, the Commission has discretion to address this issue on a step-by-step basis, by adopting interim changes to the non-rural support mechanism to target additional support to the medium-size ILECs, and then subsequently revising its rules to address this issue with respect to the remaining non-rural ILECs.

A. Compliance With The Tenth Circuit's Mandate Cannot Await Comprehensive Universal Service Reform.

Qwest applauds the Commission's efforts to undertake comprehensive universal service reform in the pending *Notice of Proposed Rulemakings.*[75] Given the huge complexity of this

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[75] *In the Matter of High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, Notice of Proposed Rulemaking, 23 FCC Rcd 1531 (2008); 73 Fed. Reg. 11587, Mar. 4, 2008; *In the Matter of High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, Notice of Proposed Rulemaking, 23 FCC Rcd 1467 (2008); 73 Fed. Reg. 11580, Mar. 4, 2008; *In the Matter of High-Cost Universal Service Support;*

task, however, such an overhaul of the current system is not close at hand. The Commission, Joint Board, and industry members have been working on universal service reform for a number of years, yet intractable problems remain, without a clear consensus on how to address these issues. For the reasons discussed above, the Commission cannot wait for the completion of comprehensive reform to address the key points of the Tenth Circuit's decision.

B. The Commission Should Revise The Non-Rural High-Cost Support Mechanism To Target Support To Rural Areas.

Under the Commission's current rules, federal high-cost support for non-rural carriers is based on statewide average costs. Consequently, the amount of support provided in a particular rural area may bear little relationship to the cost of providing service in that area. Rather, such support is determined largely by the proportion of relatively high-cost and low-cost lines in the state. As discussed above, such reliance on implicit subsidies is no longer workable and is inconsistent with the statutory mandate for reasonably comparable rates and services in rural and urban areas. The Commission therefore should revise the non-rural support mechanism to target federal high-cost support to the highest-cost wire centers.

As an initial matter, *Qwest II* requires the Commission to revisit its definition of "sufficient" support. In addressing the Tenth Circuit's mandate in *Qwest II*, the Commission should define federal universal service support as "sufficient" if it is enough to achieve the seven principles specified in Section 254(b), including reasonable comparability, affordability, access to advanced services, and the availability of quality services throughout the nation.[76] Full

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Federal-State Joint Board on Universal Service, Notice of Proposed Rulemaking, 23 FCC Rcd 1495 (2008); 73 Fed. Reg. 11591, Mar. 4, 2008.

[76] *See Qwest II*, 398 F.3d at 1234.

compliance with this aspect of *Qwest II* may require further investigation and data gathering, which the Commission should initiate expeditiously. In the meantime, the Commission should move forward to ensure reasonable comparability.

Under the Commission's current rules, rural rates are presumed "reasonably comparable" if they fall within two standard deviations of the national urban rate. As noted, the Tenth Circuit found that this benchmark rested on a "faulty" interpretation of the Act because it does not fulfill the Commission's obligation to "advance," as well as "preserve," universal service.[77] In contrast, a benchmark set at 125 percent of the national urban rate would advance universal service by ensuring a smaller variance in rural and urban rates. It also would address the Tenth Circuit's concern about the Commission's current use of a cost-based benchmark, given the statute's requirement for reasonably comparable *rates*. If the Commission ensures that the cost of providing service in rural wire centers is reasonably comparable to the average urban rate, there is no question that the rural rate should be within that range. Finally, this lower benchmark would also advance universal service by helping to make broadband services more readily available in rural areas, in furtherance of Section 254(b)(2). For these reasons, the Commission should adopt a benchmark of 125 percent of the national urban rate.

In addition to directly addressing the loss of implicit subsidies, this modification to the non-rural support mechanism is also consistent with the current methodology for rural carriers. In the *Order on Remand*, the Commission found that statewide averaging is not appropriate for rural ILECs because of their smaller scale.[78] As discussed above, the loss of implicit subsidies

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[77] *Id.* at 1236-37.

[78] *Order on Remand,* 18 FCC Rcd at 22573-74 ¶ 25.

significantly narrows the distinction between rural ILECs and non-rural ILECs -- particularly the medium-size ILECs -- in this regard.

A comparison of urban and rural rates in Qwest's territory, along with urban and rural costs (as estimated by the Commission's Synthesis Model), reveals that Qwest's urban rates are providing unsustainable implicit subsidies to support rural residential rates.[79] Attachment A shows examples of the gap between the local exchange rate in Qwest's rural wire centers and the cost to provide local exchange service, as calculated by the Commission's Synthesis Model. The residential local service rate in Patagonia, AZ, for example, is $20.98 per month, while the monthly cost of providing that service is over $126. Therefore, other Qwest services must provide an additional contribution (*i.e.*, implicit subsidy) of $105 per month in order to cover the local service cost of a single residential customer in Patagonia. More explicit support is required to maintain comparable rates in such rural and urban areas. This wire-center-based approach would target universal service support directly to the high-cost areas that need it most, thus fulfilling Section 254's core objectives.

This proposed methodology would distribute support across the non-rural ILECs. Applying a 125 percent benchmark at the wire center level for all non-rural carriers (including AT&T and Verizon) would increase the fund size by about 1.2 billion.[80] The approximate distribution among non-rural ILECs is shown in Attachment B. If adopted, this proposal would replace the existing support mechanism for non-rural ILECs.

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[79] *See* Attachment A.

[80] *See* Attachment B. This estimate assumes that the Commission freezes current support for CETCs.

C. The Commission Could Reasonably Decide, On An Interim Basis, First To Take Steps To Ensure Reasonable Comparability In Rural Areas Served By The Medium-Size ILECs.

Given the dramatic difference in size, scope, and scale between the medium-size ILECs and the two largest non-rural ILECs, the Commission could reasonably decide, on an interim basis, to modify the high-cost methodology only for the medium-size ILECs, and then address this issue for AT&T and Verizon in a subsequent order. By doing so, the Commission could limit the increase in the current non-rural program to about $322 million.[81]

Nothing in the statute precludes the Commission from limiting the proposed interim changes to medium-size ILECs, particularly given that those carriers are most severely affected by the accelerating loss of implicit subsidies, as shown above. Courts have repeatedly confirmed that the Commission can choose to address regulatory issues on a step-by-step basis, rather than in one fell swoop.[82] Likewise, courts generally allow the Commission more discretion in adopting interim rules.[83]

Furthermore, the Commission has previously recognized that smaller carriers are more vulnerable to significant changes in universal service support, justifying differing regulatory regimes. In implementing Section 254, the Commission adopted significantly different high-cost support mechanisms for rural and non-rural carriers even though the same statutory standards apply to both categories of carriers. In doing so, the Commission recognized that "rural carriers face diverse circumstances and that 'one size does not fit all' in considering universal service

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[81] *See* Attachment B. Under this approach, the medium-size ILECs would receive approximately $402 million, while AT&T and Verizon's high-cost support would remain at the current level of about $272 million.

[82] *See, e.g., Competitive Telecommunications Association v. FCC*, 309 F.3d 8, 14-16 (D.C. Cir. 2002).

support mechanisms that are appropriate for rural carriers."[84] The Joint Board earlier noted that smaller rural carriers also "cannot respond to changing operating circumstances as quickly as large carriers."[85]

On appeal of the *Universal Service First Report and Order*, Vermont challenged the Commission's decision to apply its new high-cost support mechanism to non-rural carriers, but not smaller rural carriers. The state argued that there is no statutory or reasonable basis for distinguishing among rural carriers simply because of their size.[86] The Fifth Circuit disagreed, finding that there is no statutory requirement to adopt the same high-cost mechanism for rural carriers and that the Commission had provided adequate justification for treating the smaller carriers differently.[87] If the Commission were initially to limit the modification of the non-rural support mechanism to the medium-size ILECs, it would simply create a third category of ILECs on an interim basis for the purpose of complying with the Tenth Circuit's mandate in *Qwest II*.

In summary, this interim proposal would further the Tenth Circuit remand by promoting reasonably comparable rates and sufficient support in rural areas.

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[83] *See, e.g., id.* at 16.

[84] *In the Matter of Federal-State Joint Board on Universal Service; Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking in CC Docket No. 96-45, and Report and Order in CC Docket No. 00-256, 16 FCC Rcd 11244, 11247 ¶ 4 (2001).

[85] *Universal Service First Report and Order*, 12 FCC Rcd at 8934 ¶ 291; *see also id.* at 8936 ¶ 294 ("For many rural carriers, universal service support provides a large share of the carriers' revenues, and thus, any sudden change in the support mechanisms may disproportionately affect rural carriers' operations.").

[86] *TOPUC*, 183 F.3d at 438-39.

[87] *Id.*

IV. CONCLUSION

For the reasons discussed above, it is critical for the Commission to move forward to address the Tenth Circuit's mandate in *Qwest II.* The onset of near-ubiquitous competition in lower-cost urban areas makes continuing reliance on implicit subsidies untenable. The Commission therefore should expeditiously adopt the proposal outlined above.

Respectfully submitted,

/s/ Andrew D. Crain

Attachment A: Urban-Rural Rate and Cost Comparison

Qwest Serving Area	Urban Flat Basic Exchange Rate	Urban CALC	Total Urban Rate	Min. Urban HCPM Cost	Rural Flat Basic Exchange Rate	Rural CALC	Total Rural Rate	Max. Rural HCPM Cost	Rural CLLI	WC_NAME
AZ	$ 13.18	$ 6.30	$ 19.48	$ 12.96	$ 14.68	$ 6.30	$ 20.98	$ 126.53	PTGNAZMA	PATAGONIA
CO	$ 14.88	$ 6.50	$ 21.38	$ 13.43	$ 14.88	$ 6.50	$ 21.38	$ 137.26	DCKRCOMA	DECKERS
IA	$ 16.60	$ 4.83	$ 21.43	$ 14.43	$ 16.60	$ 4.83	$ 21.43	$ 162.28	RSHLIACO	ROSE HILL
ID	$ 19.75	$ 6.38	$ 26.13	$ 17.01	$ 13.75	$ 6.38	$ 20.13	$ 194.43	THTCIDMA	THATCHER
MN	$ 14.99	$ 4.95	$ 19.94	$ 12.45	$ 13.96	$ 4.95	$ 18.91	$ 221.06	CMSTMNCO	COMSTOCK
MT	$ 16.73	$ 6.50	$ 23.23	$ 19.52	$ 22.48	$ 6.50	$ 28.98	$ 884.73	TRRYMTMA	TERRY
ND	$ 17.57	$ 6.50	$ 24.07	$ 17.98	$ 17.57	$ 6.50	$ 24.07	$ 203.82	LNRDNDMW	LEONARD
NE	$ 18.15	$ 4.81	$ 22.96	$ 13.31	$ 20.45	$ 4.81	$ 25.26	$ 399.03	HRSNNENW	HARRISON
NM	$ 14.02	$ 6.50	$ 20.52	$ 14.74	$ 13.50	$ 6.50	$ 20.00	$ 123.33	GLLPNMFW	GALLOP/FORT WINGATE
OR	$ 12.80	$ 6.50	$ 19.30	$ 13.35	$ 19.77	$ 6.50	$ 26.27	$ 163.66	CLCKOR53	CULP CREEK
SD	$ 18.25	$ 6.47	$ 24.72	$ 17.17	$ 15.05	$ 6.47	$ 21.52	$ 448.37	MRTWSDCO	MORRISTOWN
UT	$ 13.50	$ 6.38	$ 19.88	$ 13.42	$ 12.00	$ 6.38	$ 18.38	$ 97.86	LEDSUTMA	LEEDS
WA	$ 13.50	$ 5.87	$ 19.37	$ 13.07	$ 13.50	$ 5.87	$ 19.37	$ 127.11	PMRYWA01	POMEROY
WY	$ 23.10	$ 6.50	$ 29.60	$ 20.32	$ 69.35	$ 6.50	$ 75.85	$ 240.48	MORNWYMA	MORAN

Attachment B: Proposed Non-Rural High Cost Model Fund

Benchmark			$25.27			$29.06			$31.59			$37.91
Holding Company	**Percent of Total w 100% BM**	**Percent of Medium-size w 100% BM**	**Amount of Funding w 100% BM**	**Percent of Total w 115% BM**	**Percent of Medium-Size w 115% BM**	**Amount of Funding w 115% BM**	**Percent of Total w 125% BM**	**Percent of Medium-Size w 125% BM**	**Amount of Funding w 125% BM**	**Percent of Total w 150% BM**	**Percent of Medium-Size w 150% BM**	**Amount of Funding w 150% BM**
ACS of Anchorage, Inc.	0.0%	0.2%	$1,341,495	0.0%	0.2%	$952,347	0.0%	0.2%	$692,916	0.0%	0.1%	$312,105
CenturyTel	3.3%	14.2%	$90,312,723	3.9%	16.2%	$77,520,758	4.3%	17.4%	$69,766,854	5.1%	19.7%	$53,227,600
Cincinnati Bell	0.3%	1.4%	$9,205,260	0.3%	1.2%	$5,911,379	0.3%	1.1%	$4,278,321	0.2%	0.8%	$2,215,023
Citizens	0.2%	0.8%	$5,316,990	0.1%	0.6%	$2,901,840	0.1%	0.5%	$1,966,244	0.0%	0.2%	$444,241
Embarq	0.1%	0.3%	$1,671,760	0.1%	0.3%	$1,584,714	0.1%	0.4%	$1,526,684	0.1%	0.5%	$1,381,608
Fairpoint	2.7%	11.5%	$73,047,076	2.7%	11.1%	$53,192,200	2.7%	10.9%	$43,843,839	2.6%	10.0%	$27,034,674
Hawaiian Telecm	0.3%	1.2%	$7,622,679	0.3%	1.2%	$5,595,322	0.3%	1.1%	$4,559,173	0.3%	1.0%	$2,675,375
North State Communications	0.0%	0.2%	$1,123,864	0.0%	0.1%	$264,303	0.0%	0.0%	$26,143	0.0%	0.0%	$0
Puerto Rico Tel	0.8%	3.4%	$21,454,389	0.4%	1.7%	$8,340,859	0.3%	1.0%	$4,047,558	0.1%	0.4%	$1,115,129
Qwest	13.2%	55.8%	$355,237,124	13.4%	55.1%	$263,593,210	13.6%	54.7%	$219,981,108	14.0%	53.6%	$145,058,212
Surewest	0.0%	0.0%	$0	0.0%	0.0%	$0	0.0%	0.0%	$0	0.0%	0.0%	$0
Windstream	2.6%	11.1%	$70,569,723	3.0%	12.2%	$58,418,280	3.2%	12.8%	$51,280,341	3.6%	13.7%	$37,110,351
Medium-size Fund Size =	**23.6%**	**100.0%**	**$ 636,903,082**	**24.3%**	**100.0%**	**$ 478,275,214**	**24.9%**	**100%**	**$ 401,969,179**	**26.1%**	**100.0%**	**$ 270,574,317**
AT&T	45.0%		$ 1,214,306,351	43.7%		$ 860,236,452	42.8%		$ 692,229,340	41.3%		$ 427,863,474
Verizon	31.4%		$ 847,685,735	31.9%		$ 627,845,874	32.3%		$ 522,856,414	32.5%		$ 336,990,269
Large Company Fund Size	**76.4%**		**$2,061,992,086**	**75.7%**		**$1,488,082,326**	**75.1%**		**$1,215,085,754**	**73.9%**		**$764,853,743**
Total Non-rural Fund Size	**100.0%**		**$2,698,895,167**	**100.0%**		**$1,966,357,540**	**100.0%**		**$1,617,054,933**	**100.0%**		**$1,035,428,060**

Holding Company	2008 FUSF	With CETCs
ACS of Anchorage, Inc.	$0	$0
CenturyTel	$12,418,515	$15,263,040
Cincinnati Bell	$688,709	$855,400
Citizens	$0	$0
Embarq	$0	$0
Fairpoint	$9,087,168	$11,986,121
Hawaiian Telecm	$0	$0
North State Communications	$0	$0
Puerto Rico Tel	$0	$0
Qwest	$25,626,648	$40,456,037
Surewest	$0	$0
Windstream	$6,951,250	$11,353,390
Total Medium-Size	**$54,772,290**	**$79,913,988**
AT&T	$114,233,475	$244,333,455
Verizon	$21,320,090	$27,849,473
Total Large Company	**$135,553,566**	**$272,182,928**
Total Non-Rural ILECs	**$190,325,856**	**$352,096,916**

	100% Benchmark		115% Benchmark		125% Benchmark		150% Benchmark	
State	Medium-Size Only	All NR ILECs	Medium-Size Only	All NR ILECs	Medium-Size Only	All NR ILECs	Medium-Size Only	All NR ILECs+K4
AK	$1,341,495	$1,341,495	$952,347	$952,347	$692,916	$692,916	$312,105	$312,105
AL	$46,095,961	$136,838,192	$38,712,647	$100,937,126	$34,251,072	$81,919,158	$25,381,948	$50,093,951
AR	$0	$44,445,497	$0	$32,945,991	$0	$27,541,546	$0	$18,719,487
AZ	$28,257,760	$28,257,760	$20,264,276	$20,264,276	$17,116,302	$17,116,302	$12,193,944	$12,193,944
CA	$0	$100,834,926	$0	$76,584,650	$0	$64,648,200	$0	$46,800,492
CO	$49,718,655	$49,718,655	$35,283,415	$35,283,415	$28,259,775	$28,259,775	$16,095,360	$16,095,360
CT	$0	$11,573,803	$0	$3,878,666	$0	$1,951,212	$0	$552,899
DC	$0	$0	$0	$0	$0	$0	$0	$0
DE	$0	$3,774,147	$0	$2,090,327	$0	$1,448,975	$0	$475,227
FL	$0	$29,051,726	$0	$18,219,002	$0	$13,925,249	$0	$7,385,103
GA	$0	$61,308,226	$0	$41,141,109	$0	$31,867,331	$0	$17,310,924
HI	$7,622,679	$7,622,679	$5,595,322	$5,595,322	$4,559,173	$4,559,173	$2,675,375	$2,675,375
IA	$26,681,303	$26,681,303	$17,784,629	$17,784,629	$13,392,573	$13,392,573	$8,030,552	$8,030,552
ID	$22,182,507	$22,182,507	$16,748,252	$16,748,252	$14,264,602	$14,264,602	$10,256,585	$10,256,585
IL	$0	$102,779,611	$0	$79,401,268	$0	$67,735,641	$0	$47,755,674
IN	$0	$86,394,993	$0	$62,168,073	$0	$50,648,175	$0	$31,689,687
KS	$0	$35,805,331	$0	$27,826,647	$0	$24,036,804	$0	$17,060,655
KY	$42,225,105	$114,021,241	$33,128,627	$88,637,867	$27,855,334	$74,678,556	$17,957,773	$47,978,985
LA	$0	$84,559,433	$0	$63,125,765	$0	$52,554,681	$0	$33,700,122
MA	$0	$11,180,046	$0	$5,626,728	$0	$3,701,494	$0	$1,756,738
MD	$0	$18,805,394	$0	$9,962,864	$0	$6,999,900	$0	$3,153,215
ME	$34,625,072	$34,625,072	$25,579,043	$25,579,043	$21,493,116	$21,493,116	$14,166,096	$14,166,096
MI	$0	$142,830,432	$0	$99,492,985	$0	$77,968,938	$0	$42,510,003
MN	$43,854,325	$43,854,325	$31,127,129	$31,127,129	$24,721,987	$24,721,987	$13,957,863	$13,957,863
MO	$44,216,762	$98,247,823	$38,808,111	$79,427,686	$35,515,782	$70,067,039	$27,845,652	$51,237,268
MS	$0	$148,309,297	$0	$119,225,772	$0	$102,800,402	$0	$71,897,395
MT	$33,198,135	$33,198,135	$28,597,888	$28,597,888	$25,670,731	$25,670,731	$19,867,948	$19,867,948
NC	$1,123,864	$56,663,836	$264,303	$34,884,052	$26,143	$25,707,485	$0	$12,709,247
ND	$9,603,523	$9,603,523	$7,541,633	$7,541,633	$6,388,404	$6,388,404	$4,352,894	$4,352,894
NE	$50,058,103	$50,058,103	$43,243,193	$43,243,193	$39,258,509	$39,258,509	$31,742,029	$31,742,029
NH	$15,481,301	$15,481,301	$9,820,859	$9,820,859	$7,216,665	$7,216,665	$3,281,225	$3,281,225
NJ	$0	$2,584,143	$0	$495,177	$0	$190,994	$0	$39,177
NM	$26,623,459	$26,623,459	$18,619,212	$18,619,212	$14,825,076	$14,825,076	$8,789,562	$8,789,562
NV	$1,671,760	$22,332,106	$1,584,714	$20,561,904	$1,526,684	$19,854,832	$1,381,608	$18,258,189
NY	$5,316,990	$86,462,030	$2,901,840	$59,507,881	$1,966,244	$46,778,870	$444,241	$26,650,846
OH	$10,573,537	$130,152,843	$7,459,846	$94,915,836	$5,805,495	$77,617,084	$2,651,065	$47,355,306
OK	$0	$48,344,859	$0	$36,027,411	$0	$30,080,164	$0	$20,485,687
OR	$30,428,589	$47,667,003	$20,735,053	$34,180,075	$17,195,864	$28,856,517	$9,988,688	$18,172,799
PA	$0	$54,062,311	$0	$34,503,946	$0	$26,484,903	$0	$14,702,881
PR	$21,454,389	$21,454,389	$8,340,859	$8,340,859	$4,047,558	$4,047,558	$1,115,129	$1,115,129
RI	$0	$1,423,891	$0	$389,708	$0	$87,838	$0	$0
SC	$0	$50,391,154	$0	$31,713,356	$0	$22,333,286	$0	$9,707,444
SD	$14,483,111	$14,483,111	$12,041,424	$12,041,424	$10,962,654	$10,962,654	$8,921,668	$8,921,668
TN	$0	$87,530,088	$0	$58,683,134	$0	$45,018,614	$0	$23,949,902
TX	$0	$211,827,485	$0	$155,554,805	$0	$129,511,715	$0	$86,190,006
UT	$7,456,837	$7,456,837	$5,593,721	$5,593,721	$4,754,691	$4,754,691	$3,209,389	$3,209,389
VA	$0	$78,911,803	$0	$59,741,786	$0	$49,666,777	$0	$29,966,003
VT	$22,940,703	$22,940,703	$17,792,298	$17,792,298	$15,134,057	$15,134,057	$9,587,353	$9,587,353
WA	$18,508,812	$43,087,941	$13,421,555	$32,317,571	$11,039,861	$27,689,592	$6,667,519	$19,043,289
WI	$0	$51,306,197	$0	$36,050,607	$0	$28,009,594	$0	$14,846,337
WV	$0	$58,645,656	$0	$44,879,253	$0	$37,886,665	$0	$25,017,296
WY	$21,158,348	$21,158,348	$16,333,017	$16,333,017	$14,027,911	$14,027,911	$9,700,748	$9,700,748
Totals	**$636,903,082**	**$2,698,895,167**	**$478,275,214**	**$1,966,357,540**	**$401,969,179**	**$1,617,054,933**	**$270,574,317**	**$1,035,428,060**